MORNING BRIEFING
October 31, 2023

Trick Or Treat?

Check out the accompanying chart collection.

Executive Summary: Treat: Consumers' soaring net worth since the pandemic has reduced their need to save, in our opinion. That might explain why consumer spending has been resilient despite hard-landers' warnings that households were depleting their excess saving and would have to retrench by now. … Treat: Inflation is still on course to fall to the Fed's 2.0% target. … Trick: The Treasury might spook investors again on Wednesday when it details its next round of financing needs.

Weekly Webcast. If you missed Monday's live webcast, you can view a replay *here*.

Consumers: Beware of the Saving Rate? Halloween arrived early on Wall Street. Investors have had lots to be spooked about since early this year, when the consensus was that the economy would fall into a recession. That hasn't happened so far, mostly because consumer spending remained surprisingly strong.

The hard-landers have been expecting that consumers would have to start saving more this year once their excess saving windfall (accumulated during the pandemic) was depleted. They've reckoned that would happen around now. They could still be right, but it doesn't look that way from consumers' recent behavior: Consumers have been reducing their saving rate in recent months, bolstering the upward trend in their inflation-adjusted disposable income.

That behavior is consistent with our view that consumers' net worth has soared since the pandemic, reducing their need to save. In addition, retiring Baby Boomers are likely spending the "excess saving" they accumulated during their careers in retirement accounts. Let's have a closer look at the latest relevant data:

(1) *Disposable income is on an uptrend.* Excluding the three rounds of pandemic relief checks, real disposable personal income (RDPI) mostly fell during 2020 through 2022. This year, it rose 3.0% during the first nine months of the year (*Fig. 1*). It dipped 0.4% over the last three months, mostly because of a spike in gasoline prices.

Bolstering real RDPI since the end of the lockdowns has been aggregate weekly hours worked, which is payroll employment multiplied by the average length of the workweek in the private sector (*Fig. 2*). Depressing RDPI has been real average hourly earnings (RAHE), which stagnated during 2020-22 as inflation soared (*Fig. 3*). This year, it has resumed climbing along its uptrend since 1995, i.e., growth at a 1.2% annual rate on average.

(2) *Saving rate remains low.* Household net worth rose to a record $154.3 trillion at the end of Q2-2023 (*Fig. 4*). That's up $37.6 trillion since the end of 2019, just before the pandemic. It's been hovering around a record 8.0% of disposable personal income over this period (*Fig. 5*). Half of households' net worth (i.e., $77.1 trillion) is owned by the Baby Boomers (*Fig. 6*).

The Baby Boomers are currently 59-77 years old (*Fig. 7*). The oldest of them turned 65 years old during 2011 (*Fig. 8*). Since then, the number of seniors (i.e., aged 65 or older) has increased by 18.3 million, with 4.1 million of those younger seniors remaining in the labor force and 14.2 million having dropped out of the labor force.

The pandemic probably convinced more Baby Boomers to retire or to work part-time from home. The ones who are retiring must be saving less and spending more of their retirement net worth. If so, then the personal saving rate may remain below its pre-pandemic level. It was 7.2% during January 2020. It was down to 3.4% in September.

Inflation: Beware of the Devil in the Details? Investors have been spooked by inflation since Halloween 2021 as the CPI soared to peak at 9.1% during June 2022. It was down to 3.7% during September of this year. Yet investors are still spooked, fearing that inflation will remain stuck above the Fed's 2.0% target or will rebound as it did during the 1970s. Consider the following:

(1) We've recently observed that the headline and core CPI inflation rates were both 2.0% in September excluding shelter. Of course, the Fed tends to give more weight to the PCED inflation rate. The headline and core inflation rates for this measure of consumer prices were 3.4% and 3.7% during September (*Fig. 9*).

Excluding rent, the headline and core PCED inflation rates were down to 2.8% and 3.0% in September (*Fig. 10*). Both are down sharply from their 2022 peaks of 7.4% and 5.9%.

(2) Yes, but what about the "supercore" inflation rate that Fed Chair Powell has been focusing on? It is the PCED inflation rate excluding energy and housing. It edged down to

4.3% in September but has been stuck around 4.5%-5.0% for the past 27 months (*Fig. 11*). We are optimistic that it too will moderate in coming months given the sharp drop in the core CPI excluding shelter in recent months.

(3) And what about "Swiftflation"? The PCED inflation rate for movies, theaters, concerts, and sporting events jumped to 5.6% just before "Taylor Swift: The Era Tour" concert this past summer (*Fig. 12*). It jumped again to 10.4% when Taylor Swift started attending football games to see her boyfriend play.

(4) They say that the devil is in the details. That may very well be true about the outlook for inflation. However, inflation is usually defined as a general and relatively broad increase in prices. In any one month, a few of the CPI's components might account for much of the increase or decrease that month. It's the underlying trend that matters. That's what we look to most for either confirmation of our outlook or the need to change it. The latest data confirm for us that our narrative remains on track: Inflation is continuing to moderate.

Federal Deficit: Beware of Janet Yellen? Janet Yellen is very mild mannered. When she was running the Fed, we often referred to her as the "Fairy Godmother of the Bull Market" in stocks. She is widely respected. Now as the Secretary of the US Treasury, her most powerful detractors are the Bond Vigilantes. They claim that she was wrong about the inflationary consequences of the Biden administration's 2022 fiscal spending acts. They are also upset about the huge federal deficits that are widening under her watch. So they've pushed the bond yield up to 5.00% in protest and are threatening to push it higher if she doesn't respond to their concerns.

She responded to their threats on October 26 at an *event* in Bloomberg's Washington office. She dismissed the notion that bond yields are rising just because the Treasury's financing needs have swelled. She stated: "I don't think much of that is connected." She blamed higher interest rates on the strong economy: "The economy is continuing to show tremendous robustness and that suggests that interest rates are likely to stay higher for longer," she said.

She supported her spin by stating that interest rates are going up in advanced countries around the world even those without significant government budget deficits. That's a weak argument since interest rates around the world tend to follow the lead of US interest rates.

Yellen will provide the trick or treat on Wednesday when the Treasury will detail its next round of financing needs.

Calendars

US: Tues: Consumer Confidence Index 100.0; Employment Cost Index 1/0%q.q; S&P/CS HPI Composite 1.6%y/y; Chicago PMI 45.0. **Wed:** Fed Interest Rate Decision 5.50%; ADP Employment 141k; Job Openings 9.27m; ISM M-PMI & Price Index 50.0/44.9; Construction Spending 0.4%; MBA Mortgage Applications; Crude Oil Inventories & Gasoline Production. (FXStreet estimates)

Global: Tues: Eurozone GDP -0.1%q/q/0.2%y/y; Eurozone Headline & Core CPI 3.2%/4.2%y/y; Germany Retail Sales 0.5%m/m/-1.2%y/y; Germany Import Price Index 0.4%; France GDP 0.1%q/q; France CPI 0.2%m/m/4.6%y/y; France Consumer Spending 0.4%; Italy GDP 0.1%; Italy CPI 0.6%m/m/2.6%y/y; Japan Household Confidence 35.1; Japan Housing Stats -4.7%; China Caixin M-PMI 50.8; BoJ Press Conference; De Guindos; Wuermeling; Nagel. **Wed:** US-PMI 45.2; UK Nationwide HPI -0.3%; Rogers. (FXStreet estimates)

Strategy Indicators

S&P 500/400/600 Forward Earnings (*link*): Forward earnings fell for all three of these indexes during the October 27 week in their first simultaneous decline since the July 14 week. LargeCap's forward earnings edged down less than 0.1% from a record high a week earlier after first hitting that mark during the September 15 week for the first time in 15 months, dating back to the June 24 week of 2022. MidCap's dropped 0.3% w/w to 4.4% below its record high in early June 2022, and SmallCap's fell 0.4% w/w to 7.6% below its mid-June 2022 record. Through the week ending October 27, LargeCap's forward earnings has risen 6.9% from its 54-week low during the week of February 10; MidCap's is 4.1% above its 55-week low during the week of March 10; and SmallCap's is 6.9% above its 72-week low during the March 17 week. These three indexes' forward earnings downtrend since mid-2022 has been relatively modest compared to their deep double-digit percentage declines during the Great Virus Crisis and the Great Financial Crisis. Forward earnings momentum remains near two-year lows but is steadily ticking higher now. The yearly rate of change in LargeCap's forward earnings has improved to 3.5% y/y from a 29-month low of -3.2% y/y during the June 23 week. Those levels compare to a record-high 42.2% at the end of July 2021 and, on the downside, to -19.3% in May 2020, which was the lowest since October 2009. MidCap's rate of -0.9% y/y is up from a 31-month low of -5.9% in early June, which compares to a record high of 78.8% in May 2021 and a record low of -32.7% in May 2020. SmallCap's -4.4% y/y rate is up from a 32-month low of -12.9% in mid-June and down from a record high of 124.2% in June 2021; it compares to a record low of -41.5% in June 2020. Analysts' consensus earnings forecasts for 2023 and 2024 had been heading steadily lower since June of last year, but the 2023 estimate for the S&P 500 ticked higher during the Q1 and Q2 reporting seasons as analysts incorporated the strong earnings beats into their forecasts. Here are the latest consensus earnings growth rates for 2023 and 2024: LargeCap (0.8% and 11.9%), MidCap (-12.7, 12.8), and SmallCap (-7.1, 11.0).

S&P 500/400/600 Valuation (*link*): Valuations moved lower for these three indexes during the October 27 week. LargeCap's forward P/E was down 0.5pt w/w to a seven-month low of 17.0. That's down from its 18-month high of 19.6 during the July 28 week. It's still up 1.9pts from its 30-month low of 15.1 at the end of September 2022, which compares to an 11-year low of 11.1 during March 2020. MidCap's forward P/E fell 0.3pt w/w to a 12-month low of 12.1. It's now 2.6pts below its 10-month high of 14.7 in early February and up 1.0pt from its 30-month low of 11.1 at the end of September 2022, which compares to a record high of 22.9 in June 2020 and an 11-year low of 10.7 in March 2020. SmallCap's forward P/E fell 0.2pt w/w to a 12-month low of 11.3, and is now 3.0pt below its recent 12-month high of 14.3 in early February. It's up 0.7pts from its 14-year low of 10.6 in September 2022 and compares to a record low of 10.2 in November 2009 during the Great Financial Crisis. That also compares to its record high of 26.7 in early June 2020 when forward earnings was depressed. The forward P/Es for the SMidCaps have been mostly below LargeCap's since August 2018. MidCap's 29% discount to LargeCap's P/E remains near its 24-year-low 30% discount during the June 23 week. It had been at a 21% discount during the March 17 week, which was near its best reading since November 2021. SmallCap's is at a 23-year-low discount of 34%, which compares to a 22% discount during the March 10 week; that one was near its lowest discount since August 2021. SmallCap's P/E had been mostly above LargeCap's since 2003. Looking at SmallCap's P/E relative to MidCap's, it was at a discount for a 124th straight week; the current 7% discount is an improvement from its 20-year-low 9% discount in December 2021.

S&P 500 Sectors Quarterly Earnings Outlook (*link*): Following the Q3-2020 earnings season, when the US economy emerged from the Covid shutdown, analysts began raising their consensus forecasts for future quarters instead of lowering them as is the historical norm. That six-quarter streak of positive revisions throughout the quarter ended during Q1-2022, and the estimate declines accelerated considerably for the three quarters through Q1-2023 before easing for Q2-2023. Looking at Q3-2023, the revisions pendulum turned slightly negative w/w in the usual performance right before the start of the earnings season ahead of the typical earnings surprise hook. They're forecasting that the S&P 500's earnings rose 1.3% y/y in Q3-2023. That's up from a 5.8% decline in Q2-2023, which likely marked the cyclical bottom for earnings growth. On a pro forma basis, they expect a y/y earnings gain of 4.3% in Q3, up from a 2.8% decline in Q2-2023. S&P 500 ex-Energy earnings are forecasted to be up 9.7% y/y in Q3-2023, an improvement from the 3.6% gain in Q2-2023, the 1.6% decline in Q1-2023, and the 7.4% drop in Q4-2022. Seven sectors are expected to record positive y/y percentage earnings growth in Q3-2023, unchanged from Q2-2023's count. However, that's up from five sectors that did so in Q1-2023 and up from only two in Q4-2022. Here are the S&P 500 sectors' expected blended earnings growth rates for Q3-2023 versus their final earnings growth rates for Q2-2023: Communication Services (45.7% in Q3-2023 versus 15.7% in Q2-2023), Consumer Discretionary (33.4, 57.0), Financials (20.3, 9.3), Information Technology (10.4, 5.0), S&P 500 ex-Energy (9.7, 3.6), Utilities (9.5, 0.6), Industrials (9.1, 15.7), S&P 500 (4.3, -2.8), Consumer Staples (4.1, 8.5), Real Estate (-6.6, -2.1), Health Care (-17.0, -26.7), Materials (-19.0, -26.4), and Energy (-34.9, -47.5).

US Economic Indicators

Regional M-PMIs (*link*): Five Fed districts so far have reported on manufacturing activity for October—New York, Philadelphia, Richmond, Kansas City, and Dallas—and collectively they show a contraction in manufacturing during the month. *Manufacturing activity* (to -7.6 from -6.5) continued to decline at a fairly steady pace, as the New York (-4.6 from 1.9) measure moved from expansion to contraction, while Philadelphia's (-9.0 from -13.5) declined at a slower pace, and Richmond's (3.0 from 5.0) rose at a slightly slower pace; Kansas City's was unchanged at -8.0. Meanwhile, manufacturing activity in the Dallas (-19.2 from -18.1) area continued to decline at a fast pace. *New orders* (-6.9 from –4.3) contracted at a slightly faster pace in October, as billings in the Philadelphia (4.4 from -10.2) area posted a 14.6-point swing back into expansionary territory, while the New York (-4.2 from 5.1) and Richmond (-4.0 from 3.0) measures recorded negative 9.3-point and negative 7.0-point swings, respectively, back into contractionary territory. The Kansas City (-22.0 from -14.0) measure fell deeper into negative territory, as did the Dallas (-8.8 from -5.2) gauge, though not as dramatically as Kansas City's. *Employment* (3.4 from 2.8) showed factories are slow to hire, bouncing around zero for the past few months, as factories in the New York (3.1 from -2.7), Philadelphia (4.0 from -5.7), and Richmond (unchanged at 7.0) regions all hired at a sluggish pace, while growth in the Dallas (6.7 from 13.6) region was cut in half. Meanwhile, Kansas City (-4.0 from 2.0) manufacturers showed a slight shortfall in hiring.

Regional Prices Paid & Received Measures (*link*): We now have October prices-paid and -received data for the five Fed regions—New York, Philadelphia, Richmond, Kansas City, and Dallas. (Note: The New York, Philadelphia, Dallas, and Kansas City measures are diffusion indexes, while Richmond's measures are average annualized inflation rates—which we multiply by 10 for easier comparison to the other regional measures.) The *prices-paid* measure in October slowed to 18.1 after picking up a bit from 16.7 in June to 24.8 in September, bouncing around recent lows. It was as high as 40.7 this February, though peaked at 90.1 during November 2021. Regionally, *prices-paid* indexes show the Philadelphia (23.1 from 25.7) measure held steady in October, though is up from April's 8.2 reading—which was its lowest since mid-2020—while New York's (25.5 from 25.8) measure also showed little change. The Richmond (30.2 from 40.6) measure continued to ease from its record high of 152.9 last May, while the Dallas (13.6 from 25.0) measure increased at roughly half the pace. Kansas City's (-2.0 from 7.0) gauge dipped into negative territory from its record high of 84.0 during October and May of 2021. Turning to the *prices-received* measure, it eased to 9.0 in October—the slowest since October 2020. It was at a record high of 59.0 in March 2022. Regionally, *prices-received* indexes saw New York's (11.7 from 19.6) gauge slow a bit, though was up from July's three-year low of 3.9, while Philadelphia's (14.6 from 14.8) measure barely budged again during October, though did ease from May's 23.0. Meanwhile, Richmond's (20.7 from 30.6) gauge continued to ease from its record high of 106.3 last June. Kansas City's (0.0 from 2.0) measure continued to hover around zero, up from July and August readings of -7.0 and -6.0, respectively. Dallas' (-2.1 from 1.8) is also bouncing around zero in recent months; it was at a record high of 51.3 during October 2021. New York's gauge was at a record high of 56.1 in March 2022, while Philadelphia's reached its record high of 65.8 in November 2021.

Global Economic Indicators

Eurozone Economic Sentiment Indicators (*link*): The Economic Sentiment Indexes (ESIs) for the both the EU and Eurozone were broadly stable in October after dropping in seven of the prior eight months. The *EU's measure* ticked up 0.2 points to 93.1 this month, after falling 4.7 points (to 92.9 from 97.6) during the eight months through September, while the *Eurozone's gauge* fell for the eighth time in nine months, by 0.1 point in October and 6.2 points over the period—down from their January readings of 97.6 and 99.5, respectively; they were at record highs of 117.7 and 118.7 during October 2021. ESIs among the *six largest EU economies* were mixed in October, with ESIs rising in Poland (+1.4 points to 97.0), Spain (+1.2 to 100.3), and Germany (+0.5 to 89.6) and falling in France (-2.9 to 93.5) and Italy (-0.9 to 96.9); the Netherland's ESI was unchanged at 93.1. By sector, *service* confidence edged up 0.4 point to 4.8 in October, after no change in September; it had dropped 3.2 points during the four months through August (to 4.4 from 7.6). It's down 14.6 points from its recent peak of 19.4 during October 2021. *Consumer* confidence in the overall EU was unchanged in October, after edging down the prior two months by 2.6 points to -18.7. Before the recent weakness, it had surged 13.7 points from last September's record low of -29.8 to -16.1 by this July. *Industrial* confidence remained broadly stable again this month, hovering around -9.0 the past few months, after a 22.0-point freefall from a record high of 12.8 in December 2021 to -9.2 in July. *Retail trade* confidence fell for the fifth time in six months, by 5.0 points to -6.4, though retailers were more optimistic about their future financial situation for the second straight month. *Construction* confidence stabilized in October, ticking up 0.2 point to -8.2 after deteriorating from a record high of 8.4 at the end of 2021 to -8.4 this September. The percentage of construction managers indicating insufficient demand as a factor limiting their activity increased further by 0.9ppt to 29.6%.

Contact us by *email* or call 480-664-1333.

Ed Yardeni, President & Chief Investment Strategist, 516-972-7683
Debbie Johnson, Chief Economist, 480-664-1333
Joe Abbott, Chief Quantitative Strategist, 732-497-5306
Melissa Tagg, Director of Research Projects & Operations, 516-782-9967
Mali Quintana, Senior Economist, 480-664-1333
Jackie Doherty, Contributing Editor, 917-328-6848
Valerie de la Rue, Director of Institutional Sales, 516-277-2432
Mary Fanslau, Manager of Client Services, 480-664-1333
Sandy Cohan, Senior Editor, 570-228-9102